

Should Wall Street Stay Out Of The Nation's Housing Market?

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Private equity is often blamed for increases in housing prices. Is this blame justified?

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Some Wall Street investors have turned their attention to buying single-family houses around the United States, renting them out for a monthly return and then selling when it makes sense for a capital gain. In response to private equity's involvement in the nation's housing market, we hear regularly that it's a "bad thing" for Wall Street investors to own and rent houses.

Some argue that Wall Street crowds out regular homeowners in favor of private equity's participation in the market. That supposedly drives up prices and rents. Others argue that a professional class of investors is profiteering (a bad thing) off typical American households. Many don't like it when Wall Street seems to treat housing as a transient generic investment vehicle in the same bucket as stocks and soybean futures. For all these reasons and more, legislators from both sides of the aisle have talked about passing laws against Wall Street participation in the U.S. housing market.

Is Wall Street ownership, management, and trading of properties such a bad thing? Not really, according to Ken Johnson, professor of real estate and finance at the University of Mississippi. Johnson says: “The critics are wrong, and their arguments fail basic economic logic. Most people (politicians included) are looking for a bogeyman to explain the current housing crisis, and Wall Street is the perfect scapegoat.”

Johnson argues that Wall Street investors bring much needed capital to incentivize developers to build more housing, thus helping to expand overall housing supply at a critical moment when many parts of the nation suffer from a “housing crisis.” Wall Street also brings improved pricing precision — more and better information analyzed by unemotional investment professionals. Greater pricing precision for any asset, including housing, reduces overall market risk. To put it another way, professional investors in the housing market deliver capital, pricing precision, and lower overall market risk for all — just as they do in other financial markets.

Lower overall market risk tends to reduce the likelihood of another major crash of the housing market. That reduction in risk benefits both buyers and sellers and the larger economy. If, on the other hand, the government were to exclude professional investors from the single-family housing market, Johnson believes that would be just like forbidding them from investing in stocks, bonds, and other financial instruments, “which all recognize as a monumentally bad idea,” said Johnson.

We shouldn't care who the buyers and sellers are, according to Johnson, just as long as there are plenty of them. That's how markets work best. And it is why Wall Street investors can help mitigate rather than worsen the nation's “housing crisis.”

From the perspective of an individual household, renting and owning are reasonable substitutes for each other, said Johnson. From a sound housing policy point of view, though, they are complements to one another. “It is not a zero-sum game between renting and owning,” he said. “A sound housing market has a balance between the supply and demand for units to live in. Once society has the right number of housing units, it is then a matter of choice for households to rent or own. Unfortunately, the nation is at a point where we do not have enough total housing units. That's the crux of the problem. Wall Street investors aren't part of the problem. They are part of the solution because they help bring housing units to market. When Wall Street buys or incentivizes builders to build units, those units become part of the overall housing stock.”

If various governments want to “do something” about the “housing crisis,” they should look elsewhere, starting with the development approval process, zoning, landmarking, building codes, and regulation, among other issues. “Scapegoating Wall Street (a possible solution) is not what we should be doing,” said Johnson. “I give them an A for effort and caring but an F in overall grade due to the total absence of economic reasoning.”

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